Economic environment

After economic activity increasingly began to falter towards the end of 2018, the long-lasting upwards trend on the stock markets came to an abrupt end. Investors had to accept losses. The banks must be prepared for persistently low interest rate levels in Europe.

International perspectives

Economic development in the strongest economies lost impetus in 2018. Political uncertainties, such as the trading disputes between the USA and Europe, as well as between the USA and China, caused a gloomy mood on the markets. The US government's protectionist trade policy is having an adverse impact on corporate global value chains and, both in China and in the euro zone, has led to a slowdown in output. The markets were also burdened by uncertainty surrounding the Brexit negotiations, the fading Macron effect and the foreseeable end of Chancellor Merkel's government in Germany. The geopolitical uncertainties are making the formulation of monetary policy more difficult. Following four interest rate hikes in 2018, the US Federal Reserve (the Fed) will be more cautious in 2019. The European Central Bank (ECB) only envisages an interest rate rise in the second half of the year. Consequently, money market interest rates in Switzerland will probably still be in the negative range at the end of 2019.

USA

US President Donald Trump has provided the US economy with an additional boost thanks to an extensive tax reduction package. However, this effect will probably diminish during 2019. The US economy was, in fact, already losing impetus during the third quarter of 2018. After forecasting an economic growth rate of 2.5 per cent for 2019, the Fed revised its expectation to 2.3 per cent in December 2018. Inflation will probably also weaken somewhat in 2019. As a result of the fall in long-term interest rates in the USA, the yield curve has continued to level off. This could also be interpreted as an early warning signal of a possible recession. According to the current plans, US import tariffs will rise to their highest levels since the 1970s, which can also be seen as an indicator that the global economic picture is very likely to become even more overcast. Consequently, trading activities would be subdued.

Euro zone

The economic outlook for the euro zone is muted. Although growth should again pick up somewhat following an unexpectedly weak second half of 2018, the mood among consumers and producers has, nevertheless, deteriorated. The general uncertainty could dampen economic activity and thus the development of inflation. Bank economists, economic research institutes and international organisations have recently revised their 2019 forecasts downwards for Germany and the euro zone. For example, the Ifo Institute in Munich has revised its economic growth forecast to 1.1 per cent, whereas back in September experts were still reckoning with 1.9 per cent. The Austrian Institute for Economic Research (WIFO) reported similar findings. However, in spite of setbacks, the economic assessments of Austrian companies at the end of the year remained surprisingly confident. Starting from a relatively high level, the companies rated the economic situation as being somewhat worse; their expectations for 2019 were somewhat less positive.

Switzerland / Liechtenstein

The Swiss economy slowed down surprisingly strongly in the third quarter of 2018, with GDP declining by 0.2 per cent. According to the State Secretariat for Economic Affairs (SECO), moderate growth is to be expected in the coming quarters. The days of significantly above-average growth, however, are probably over. The situation in the Swiss financial services sector was not particularly encouraging. According to SECO, lower financial services exports and a challenging interest rate environment meant that the value added shrank in the third quarter by 1.1 per cent. In the meantime, according to the Economic Research Department of the Swiss Federal Institute of Technology in Zurich, the decline in the value-added share of the financial sector in Switzerland has probably come to an end. Since 2007, the share of value added attributable to the banks has almost halved. If there are no further setbacks (e.g. fines) in the financial services sector, profitability may rise again, according to the Economic Research Department.

In Liechtenstein, according to the "Economic Monitor Q4/2018" of the Liechtenstein Financial Market Supervisory Authority (FMA), there are no signs of a slowdown in the economy. Output has stabilised at a high level. The very positive economic situation is clearly discernible in the continually good employment figures. Employment increased by as much as 3.8 per cent in the first half year of 2018 compared to the same period in 2017, while exports of goods grew by 11 per cent.

Liechtenstein financial centre

Financial service providers in Liechtenstein benefitted in the first half of 2018 from the favourable economic environment. According to an economic report published in October by the Liechtenstein Department of Statistics, the revenue at six selected financial service providers climbed by 19 per cent in the first half of 2018 compared to the first half of 2017. Employment in the financial services sector, too, had risen by 4 per cent by the middle of 2018 compared to the corresponding period in the previous year. However, given the cloudy outlook for the global economic situation, a slowing of momentum can be expected. The Liechtenstein Bankers Association remains confident (according to an assessment published in the "Government Financial Planning 2019 to 2022"). Its member banks generally expanded strongly between 2016 and 2017. In retrospect, it can be seen that the focus and strategic realignment with regard to efficient cost management, client-oriented service and product offers and profitability paid off. New business growth areas were opened up, which promise positive developments in the future. Nevertheless, the Bankers Association also pointed out that, in a highly digitalised environment, negative interest rates, volatile financial markets, an increasing shortage of specialist staff, as well as the scope and complexity of regulatory requirements still present the Liechtenstein banks with core challenges. On the whole, however, the Bankers Association believes that, in the medium to long term, the banks' growth strategies will have a positive effect on their annual business results, employment growth and the financial situation. The Liechtenstein Investment Fund Association basically foresees continued growth. Their assessment, also published in the "Government Financial Planning 2019 to 2022") sounds positive. The Liechtenstein Investment Fund Association expects fund volume growth of 10 to 12 per cent for 2019 against the backdrop of a neutral stock market development. From 2020, it expects an increase of 4 to 7 per cent.

Interest rates

The central banks are acting very differently at the present time. The spectrum ranges from an extraordinarily expansionary monetary policy, to a withdrawal from special monetary policy measures, to an even almost "neutral" monetary policy. In December, the Fed raised its benchmark interest rate for a fourth time in 2018. It raised the interest rate by a quarter of a point to the new target corridor of 2.25 to 2.5 per cent as a reaction to the good economic situation in the USA. The Fed has signalled a more gradual rise in rates for 2019. Nevertheless, a further interest rate hike will probably be made in 2020. The US central bank also indicated a long-term interest rate of 2.8 per cent.

In comparison, the monetary policy of the ECB continues to be very expansionary. Key interest rates should remain at their present record low level until probably beyond the summer of 2019. In December 2018, however, the ECB decided to stop its bond purchasing programme at the end of 2018. It wants to gradually withdraw the programme, but continue to invest the accruing interest income from the programme in bonds. The end of the bond purchasing programme can be regarded as a first step on the long road towards normalising monetary policy.

The Swiss National Bank (SNB) still left its interest rates unchanged. The markets are assuming that it will only initiate an interest rate turnaround after the ECB has taken the first step. With a negative interest of 0.75 per cent and its readiness, if necessary, to intervene in the foreign exchange market, the SNB's policy remains extremely expansionary. An end to negative interest rates is not expected before 2020.

Currencies

In 2018, the US dollar benefitted from the growing gap in interest rates. Larger inflows of capital led to a real effective upward revaluation of the greenback. The US dollar rose almost 2 per cent against the Swiss franc, more than 5 per cent against the euro and about 6 per cent against the British pound. Investment experts expect that the dollar will gain less ground in 2019. In April 2018, the euro reached its high point of the year against the Swiss franc of CHF 1.20; by the end of December, it had slipped to CHF 1.13. The SNB believes that its own currency is overvalued. The situation on the foreign exchange market continues to be fragile. In the SNB's view, the negative interest rate and its readiness, if necessary, to intervene in the foreign exchange market are still necessary because it wants to reduce the attractiveness of investments in Swiss francs to relieve the upward pressure on the currency. However, it seems that the Swiss National Bank has not made any large market interventions for about one and a half years. Most market participants interpret this to mean that, with exchange rates of over EUR / CHF 1.14, no market interventions by the SNB are to be expected.

Equity markets

2018 ended on the stock markets with turbulence. On balance, it was a disappointing year for investors. The development on the international financial markets was characterised by higher volatility. According to an assessment made by the SNB, concerns about a global slowdown in growth, persisting uncertainty regarding Brexit, Italian fiscal policy and the continuing tensions caused by the USA's trade policy – particularly towards China – weighed heavily on the equity markets. The situation was exacerbated by an increase in long-term interest rates in the USA at the beginning of October. Analysts expect the volatility on the equity markets to persist in the short term and that 2019 will be a challenging year. There are still too many variables that are difficult to assess from an investor's perspective. Consequently, no great euphoria should be expected on the equity markets any time soon.